Postal Regulatory Commission
Submitted 6/12/2015 4:18:47 PM
Filing ID: 92540
Accepted 6/12/2015

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

PERIODIC REPORTING (PROPOSAL ONE)	Docket No. RM2015-9

PETITION OF THE UNITED STATES POSTAL SERVICE REQUESTING INITIATION OF A PROCEEDING TO CONSIDER A PROPOSED CHANGE IN ANALYTICAL PRINCIPLES (PROPOSAL ONE)
(June 12, 2015)

Pursuant to 39 C.F.R. § 3050.11, the Postal Service requests that the Commission initiate a proceeding to consider a proposal to change analytical principles relating to the Postal Service's periodic reports.

Proposal One, as discussed in greater detail in the attachment to this Petition, seeks authorization for a change in Revenue, Pieces and Weight (RPW) methodology. We are requesting that ODIS-RPW statistical estimates of revenue, pieces and weight for mail pieces with forever stamps be used directly in RPW and not adjusted by the Book Revenue Adjustment Factor (BRAF). Recent independent information on forever stamp counts from origin plant cancellation data verifies the accuracy of the ODIS-RPW estimates at a level sufficient to be considered a near census source. We also request that recognition of stamp breakage revenue be allocated to Market Dominant Other Revenue in RPW. Breakage is defined as revenue from the sales of stamps, both forever and denominated, that will never be used on mail pieces. Under current Generally Accepted Accounting Principles (GAAP), breakage revenue is recognized at the time of sales. Current RPW methodology does not specifically address breakage; allocating it through the BRAF process has an impact on product revenue, pieces and weight. With the proposed direct use of forever stamp revenue usage and the reclassification of stamp breakage to Market Dominant Other Revenue in RPW, revenue recognition from Postage in the Hands of the Public (PIHOP) adjustments from stamps will no longer be allocated to products (Docket No. RM2011-11). Finally, we also propose to remove the allocation of meter PIHOP to products (Docket No. RM2011-11).

The Postal Service requests that the Commission initiate a rulemaking proceeding pursuant to 39 C.F.R. § 3050.11 to consider this proposal.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Pricing and Product Support

____
Eric P. Koetting

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 277-6333
June 12, 2015

<u>Proposal One</u>

PROPOSED CHANGE IN RPW METHODOLOGY FOR FOREVER STAMP USAGE, STAMP BREAKAGE, AND PIHOP

OBJECTIVE:

This request asks for a change in the methodology for the treatment of product revenue, pieces and weight associated with forever stamp usage, and to allocate stamp revenue ‘breakage’ to Market Dominant Other Revenue in Revenue, Pieces and Weight (RPW) reporting. In addition, Postage-in-the-Hands-of-the-Public (PIHOP) adjustments will no longer be allocated directly to products in RPW. These adjustments trigger changes to the Book Revenue Adjustment Factor (BRAF) product formula, and to product allocation estimated by the ODIS-RPW system.

BACKGROUND:

RPW Reporting

Regulatory reporting of revenue, pieces and weight is presented in the “Revenue, Pieces and Weight By Class and Special Services” report filed quarterly with the Postal Regulatory Commission, in accordance with Commission Rule 3050.25. This report is usually referred to simply as the RPW Report. The RPW system was discussed in detail in witness Pafford’s testimony (USPS-T-3) in Docket No. R2006-1. Revenue, pieces and weight are reported for Postal Service products through various source systems such as the General Ledger Trial Balance (TB) revenues, the Bulk Revenue, Pieces and Weight (BRPW) system (Docket No. R2006-1, Library Reference LR-L-14), and the Origin-Destination Information System and Revenue, Pieces and Weight

(ODIS-RPW) probability sampling system (Docket No. R2006-1, Library References USPS-LR-L-16 and USPS-LR-L-17).

The BRPW system is an example of a 'Census' source system in RPW that produces estimates which are used directly and are not adjusted by the BRAF process (see below). At the time of Docket No.R2006-1, other census or near census sources used in RPW included, but were not limited to, certain trial balance (TB) accounts, specialized reports, and International Inbound and Outbound products. Since Docket No. R2006-1, additional census source systems have come into use in RPW that include Commission-approved Point of Sale or POS (Docket No. RM2009-10), and Business Reply Mail and Merchandise Return Service from the PostalOne system, along with the remaining product information generated from the Self Service Kiosk (SSK) retail system (Docket No. RM2014-4).

The ODIS-RPW system produces statistical estimates of all Postal Service products. However, only those ODIS-RPW system product estimates <u>not</u> reported from census or near census systems are sent to the Adjustment Revenue, Pieces and Weight (ARPW) system (Docket No. R2006-1, Library Reference USPS-LR-L-18). These ODIS-RPW estimates have been most recently termed 'ODIS-RPW single-piece sampling revenue' (Docket No. RM2011-11, Proposal Three, page 3, formula for the BRAF).

ARPW combines the census or near census sources such as BRPW and POS with ODIS-RPW single-piece sampling estimated revenue not reported from these census or near census systems. However, the ODIS-RPW single-piece sampling estimated revenue must first be 'adjusted' in the following way. First, the sum of all census revenue sources (BRPW, POS, SSK, etc.) is subtracted from TB revenue. The resultant value is termed residual trial balance revenue. The ratio of residual TB to ODIS-RPW single-piece sampling revenue is calculated, and that ratio is termed the Book Revenue Adjustment Factor or BRAF. The BRAF is multiplied by each product revenue, pieces and weight that makes up the ODIS-RPW single piece categories to provide adjusted ODIS-RPW sampling estimates. The sum of census revenue plus the adjusted ODIS-RPW single-piece sampling revenue equals TB.[1] This process was summarized in Library Reference USPS-LR-L-18, Section 2, in Docket No. R2006-1.

Forever Stamp Revenue Usage, Breakage and PIHOP

The Postal Service establishes Trial Balance revenue accounts for isolating, reporting and accounting for revenue by method of payment and for other reasons. These are termed General Ledger or GL accounts. Forever stamp sales are recorded in specific GL accounts. All forever stamp sales cannot be recognized in the month sold, as not all that revenue will be earned in that month. A portion will either never be used (‘breakage’) or are held for future use (Postage-in-the-Hands-of-the-Public or PIHOP). Breakage and PIHOP are estimated by Accounting in the following manner.

Forever Stamp Breakage. Forever stamp breakage is defined as forever stamps which will never be used on mail pieces. It includes collectable, lost and damaged or destroyed stamps. Forever stamp breakage is estimated by category of stamp (workhorse, mail use or collectable) and applied to a ‘layer’ or issue year on the forever

[1] The purpose of the BRAF adjustment, in other words, is to ensure that the sum of RPW reported revenue equals the Accounting Trial Balance revenue.

stamp.[2] Forever stamp breakage is estimated and ultimately determined at the end of the life cycle of that layer of stamps. When there are no more sales for a layer and forever usage ends as measured by ODIS-RPW, the difference between cumulative sales and cumulative usage is deemed to be breakage, and is expressed as a percentage of cumulative sales for that layer. Each accounting period, the forever breakage percentage is applied to forever sales for that layer, and that revenue is immediately recognized.[3] Accounting applies the forever breakage rate of the layer that has most recently reached the end of its life cycle to remaining open forever layers, until they themselves expire.[4] As each layer expires, Accounting then would re-estimate the breakage percentage, and apply that to the remaining open layers.

Forever Stamp Usage. ODIS-RPW data collectors record the number of forever stamps on a mail piece, and the number of other minor forever products such, as the forever embossed card or envelope. These data are expanded to national totals. A separate process calculates the value of the forever stamp layer, as the same stamp

[2] The year a forever stamp is issued is printed on the stamp. ODIS-RPW data collectors record the year on the forever stamp to determine the 'layer'.

[3] If there were, for example, $100 of sales for the 2014 layer, and the breakage rate is 5 percent, then $5 is recognized as revenue in that time period.

[4] The current forever breakage rate is 3.69 percent. The remaining layers yet to expire include 2011 through 2015. If, for example, there were $100 in sales for 2011, $500 for 2012 sales, $1,000 for 2013 sales, $5,000 for 2014 sales, and $10,000 for 2015 sales for a given accounting period, breakage for these layers would be $3.69, $18.45, $36.90, $184.5, and $369, respectively.

may be sold at several First-Class price points.[5] The value of the layer is applied to the estimated counts to estimate the forever stamp ‘usage’ revenue.

Deferred Revenue – Prepaid Postage, also known as Postage in the Hands of the Public (PIHOP). For forever stamps, the PIHOP liability at the end of any given accounting period is equal to forever stamp sales minus forever breakages minus forever stamp usage. The formulation is:

Forever PIHOP Liability = Forever Sales – Forever Breakage – Forever Usage

Adjustments to the PIHOP liability can increase or decrease the deferred revenue liability in any given time period. If, for example, $100 worth of forever stamps are sold in a specified month, ODIS-RPW estimates $85 of forever stamp usage, and breakage is $5 (breakage rate is assumed 5 percent of forever sales), then there is an increase of deferred liability posted to the Forever PIHOP Liability TB account of $10 in that time period, and a corresponding decrease in revenue. Thus, the books of the Postal Service would show $90 in revenue for forever stamps that month ($85 of usage plus $5 breakage). Conversely, with $100 in sales, $105 in forever usage, and $5 of breakage (assumed 5 percent breakage rate), there is a decrease in deferred liability of $10 in that time period and a corresponding increase in revenue. Thus the books of the Postal Service would show $110 in revenue for forever stamps that month ($105 of usage plus $5 breakage).

[5] For example, the 2013 forever stamps were originally sold at 45 cents, sold at 46 cents beginning July 2013, and are currently on sale for 49 cents.

Denominated Breakage. The methodology and assumptions for denominated stamps are different than for forever stamps. Accounting does not use ODIS-RPW denominated stamps usage estimates. Instead, the accounting model assumes two percent of sales of denominated stamps will never be used and are recognized as breakage. Similar to the proposal for forever stamp breakage, denominated stamp breakage is proposed to be assigned to Market Dominant Other Revenue.

Current BRAF

Docket No. RM2011-11 established the current BRAF methodology. In formulation, it is defined as:

$$\text{BRAF} = \frac{\text{Total Accounting USPS Revenue} - (\text{Total RPW Census Revenue})}{\text{Total ODIS-RPW Single-Piece Sampling Revenue}}\text{, or}$$

$$\text{BRAF} = \frac{\text{Residual Trial Balance}}{\text{Total ODIS-RPW Single-Piece Sampling Revenue}}$$

Commission Order No. 816 (August 19, 2011) directed that stamped and metered PIHOP adjustments be assigned to product revenues, pieces and weight using ODIS-RPW stamp and meter distribution keys, and that stamp and meter PIHOP be removed from the residual TB. Order No. 816 at 5. (See also page 10 the Postal Service's Proposal Three (May 18, 2011) in Docket No. RM2011-11: "the residual Trial Balance would exclude the revenues from the two PIHOP accounts so as not to double count").

Estimated Forever Stamp Counts at Origin[6]

ODIS-RPW is the current system by which the number of forever stamps is estimated. Because forever usage can be affected by sampling variance and/or bias, the Postal Service has been studying alternative methodologies to get exact or near exact forever stamp counts. A system that achieves near exact counts for forever stamp letter and cards is being developed, and in testing it is producing results that match ODIS-RPW almost exactly.

The new system design combines exact machine counts of letters and cards processed at origin (known as 'End-of-Run' counts) with an origin sampling system that estimates the proportion of forever stamp volume per total letter and card pieces fed.[7] The estimated count of forever stamps on letters and cards at these origin sites covers approximately 98 percent of all forever stamps.

Problems with the Current Methodology

There are several issues with the current methodology. First, estimated forever stamp usage is included in ODIS-RPW single-piece sampling revenue (the denominator of the BRAF); affecting other products adjusted by the BRAF. Because estimates of usage can be corroborated with independent system data, such estimates should come

[6] At facilities around the country that process origin mail, there are specified operations which function to cancel the stamps on collection mail and provide initial mail processing sort information for the primary outgoing operation. Machines in these operations 'face' the mail and 'cancel', or over-write stamps so they cannot be used again. There are both automated (AFCS) and manual operations. Cancelled mail pieces include First-Class single piece mail with one or more stamps.

[7] Since currently over 95 percent of all stamps are forever stamps, the sampling to derive the distribution key can rely on small samples at processing and distribution centers.

out of the adjustment process. For the last four available quarters, Q3 FY2014 through Q2 FY2015, the estimated origin forever stamp counts totaled 12.096 billion. Over the same period ODIS-RPW estimated 12.076 billion. Quarterly estimates were both above and below, indicating the unbiased nature of ODIS-RPW. These differences in aggregate are less than two-tenths of one percent.

Second, when forever stamps were first introduced in 2007, breakage rates were estimated to be very small, at around 0.5 percent of forever sales. The allocation of breakage to the products, since it was not expressly identified in the BRAF, had minimal impact. Now, however, breakage is estimated at a weighted average 3.69 percent. In FY2014, forever breakage revenue was $231.4 million on forever stamp sales of $6.4 billion. Denominated breakage for the same period totaled $14.7 million on sales of $734 million. Breakage revenue is not product related, and should be allocated to Other Revenue.

Finally, when Accounting posts large increases or decreases in deferred revenue and revenue due to forever PIHOP adjustments, RPW product estimates on a monthly basis are disproportionally affected. For example, in January 2014, prior to the three-cent rate increase for the one-ounce stamp rate, there was a significant buy up of forever stamps. Sales significantly exceeded usage, with Accounting posting an increase in the deferred PIHOP liability for forever stamps of -$360.9 million. Since stamp PIHOP adjustments are assigned mostly to First-Class single piece, revenue, volume and weight appeared abnormally low for that category. In contrast, in January 2015, there was not a price increases for the First-Class one ounce rate, and deferred liability actually decreased by $4.5 million. When compared to SPLY, the January 2015

RPW report for First-Class single-piece showed a 10.1 percent increase in volume and a 15.3 percent increase in revenue. These figures were not credible, considering First-Class single piece revenue and volume has been on a steady yearly decline. Correcting these January numbers using the proposed methodology for both current and SPLY resulted in more reasonable estimates of declines in revenue (-3.2 percent) and volume (-8.3 percent).[8]

PROPOSAL:

The proposed methodology follows from the above discussion. ODIS-RPW estimates for products bearing forever stamps would be used directly in the RPW report. Forever stamp revenue usage would be removed from the ODIS-RPW Single-Piece Sampling Revenue in the BRAF formulation. Breakage from both forever and non-forever stamp sales would be assigned to Market Dominant Other Revenue in the RPW report. In the BRAF formulation, residual TB would remove forever stamp usage and breakage so as not to double count. Finally, the allocation of PIHOP adjustments to products would be removed. Specifically, we propose that:

[8] The proposed methodology would ameliorate the effects of PIHOP "shocks" because treating forever usage as a near-census figure and incorporating it into the right-hand term of the BRAF numerator allows it to offset variations in PIHOP entering into the left-hand term of the numerator. The algebra underlying this relationship is explained in more detail in footnote 9, below.

(1) The BRAF construction will be as follows:

$$\boldsymbol{BRAF} = \frac{\boldsymbol{Total\ Accounting\ Revenue\ - \{Forever\ Usage + Forever\ Breakage + \ Denominated\ Breakage\ + Census\}}}{\boldsymbol{Total\ ODISRPW\ Sıngl\widehat{e\ Pı}ece\ Samplıng\ Revenue}}$$

a) ODIS-RPW estimated product revenue, pieces and weight would be considered a near census source for items bearing a forever stamp, would be included directly in the RPW report, and would thus be removed from ODIS-RPW Single-Piece Sampling Revenue in the denominator of the BRAF formulation.

b) Residual TB calculated in the numerator of the BRAF ratio would no longer implicitly reflect Forever stamp revenue usage and breakage (because they will explicitly be added to the right-hand term subtracted from General Ledger revenue).[9] .

(2) Forever Breakage – Will be assigned to Market Dominant Other Revenue. Since forever breakage is revenue recognized in the time period of sales and will never be used on products, it should be assigned to non-product related

[9] Forever Stamp PIHOP adjustment equals Forever Stamp Sales minus Forever Stamp Breakage minus Forever Stamp Usage. Algebraically rewriting, we see that Forever Stamp Sales minus Forever Stamp PIHOP adjustments equals Forever Stamp Usage plus Forever Stamp Breakage. Forever Stamp Sales and Forever Stamp PIHOP adjustments are (in both the current and proposed methodology) TB accounts encompassed within the left-hand term of the BRAF numerator. Under the proposed methodology, their effects within the left-hand term will now be canceled out by including Forever Stamp Usage and breakage (which, as just demonstrated, are arithmetically equivalent in effect) within the right-hand term of the BRAF numerator.

lines of the RPW report. Since forever stamps are one-ounce letter rated, they should be assigned to the Market Dominant portion of Other Revenue.

(3) Denominated Breakage – Will similarly be assigned to Market Dominant Other Revenue, as breakage is minimal and denominated stamps are almost all used on First-Class Letters and Cards.

(4) Stamp and Meter PIHOP – These PIHOP revenues will no longer be allocated directly to products as specified in Order No. 816 at 5.

RATIONALE:

RPW reporting methodology must adapt to changes that occur with source system data, accounting practices and the like. Recent filings have focused on the replacement of statistical estimates with system data (Docket Nos. RM2009-10, RM2014-4). Information corroborating the accuracy of ODIS-RPW estimated forever counts gives evidence that these data are equivalently reliable to be considered as a direct source used in RPW. Since the inception of forever stamps, and especially after 2010 when all first ounce single-piece stamps became forever stamps, forever stamp sales have increased, and estimated breakage rates have been revised upward. The methodology of recording breakage, not specifically addressed previously, must adapt to ensure accurate product reporting.

IMPACT:

In the Excel files attached to this proposal electronically, three tables are provided that assess the impact on RPW reporting. Table 1 shows the BRAF calculations for FY2014 for current and proposed methodologies. Table 2 shows the FY2014 RPW report for the current and proposed methodologies and the percent difference. Table 3 shows the same information for Quarter 2 Year-to-Date for FY2015. Nonpublic versions of Tables 2 and 3 (including more detailed breakout of competitive product data) are provided under seal in USPS-FY2015-9/NP1.

The top portion of Table 1 shows the BRAF resulting from the current methodology, and the bottom portion shows the BRAF resulting from the proposed methodology. The middle portion shows the components of the BRAF calculation that change between the two versions. Across both versions, of course, the total TB stays constant at $67.85 billion. And in each version, the numerator is the residual trial balance, the difference between the total TB and the subtotal from census or near-census data sources. On net, in other words, the numerator in some sense represents the *expectation* of what the corresponding remaining subtotal (i.e., of sampled data -- the data not from census or near-census data) should be. The denominator, in turn, represents the *reality* of what the sampled revenue data subtotal actually is. In essence, this proposal would primarily change the designation of certain data sources from “sampled to “near-census,” and consequently would alter the composition of terms in both the numerator and denominator of the BRAF calculation.

For example, in the current methodology, FY2014 deferred PIHOP liability adjustments of -$279.8M for forever stamps and $10.5M for meter PIHOP liability adjustments are included in the right-hand term in the numerator, and thus reduce the residual trial balance by those amounts. The residual trial balance does not specifically address either forever revenue usage or breakage. In the denominator, total sampling revenue currently is relatively high at $17.2B, because it implicitly includes forever revenue usage. The current BRAF, the ratio of the current residual trial balance to the current sampling revenue, calculates to 1.0114.

In the proposed methodology, the FY2014 amounts of $5.78 billion of forever usage, $231.5 million of forever breakage and $14.7 million of denominated breakage are introduced into the right-hand term of the numerator (because they are now considered to reflect near-census data sources), thereby reducing the residual trial balance by those amounts.. By the same token, the same $5.78 billion of forever stamp usage that shifted up to the numerator must be removed from the total ODIS-RPW sampling revenue in the denominator. The amounts for forever PIHOP and meter PIHOP, currently included in the right-hand term in the numerator, are proposed to be removed. After all of the proposed changes to the residual trial balance and the sampling revenue, the proposed BRAF ratio would calculate to 0.9715.

Table 2 shows the FY2014 results, in RPW report format, for the proposed and current methodologies. The first thing to notice is that most categories are unaffected by this methodology change, because of their heavy reliance on the direct use of census data. For example, all Standard Mail comes from BRPW except for a few mail fees identified from ODIS-RPW. The second thing to notice is that Market Dominant Other Revenue on page 2 increases by $246,125(000), which is sum of the breakage shown in table 1 for forever and denominated. Third, note, that relative changes within the product categories are being impacted by changes in the BRAF formulation and the introduction of product revenue associated with forever usage. These factors mostly affect First-Class single piece letters and cards. Since the BRAF declined from 1.01 to

0.97, most product categories affected by the BRAF are reduced. The exception is Total First-Class single-piece letters and cards, a category which the proposed methodology change would cause to increase (+0.8 percent for revenue and +0.9 percent for volume). That increase is primarily due to the introduction of the forever product revenue, pieces and weight. Finally, the shift in methodology has the effect of increasing Total Market Dominant Revenue $235.1 million (bottom of page 2), which is offset by the same amount; a decline in Total Competitive revenue of $235.1 million (page 4). Most of the product declines in competitive are in First-Class Package Service (-3.6 percent for revenue and -3.5 percent for volume) and Priority Mail (-2.6 percent for revenue and -2.8 percent for volume).

Table 3 shows the Q2 Year-to-Date FY2015 results, in a similar format as Table 2. The results are consistent with FY2014. Total First-Class single piece letters and cards increased +1.0 percent on revenue and +0.6 percent on volume under the proposed methodology. Market Dominant Other Revenue on page 2 increased $131,481(000), which is, for a six-month period, about one-half of the annual amount for FY2014. Most of the product declines for competitive products showed up in First-Class Package Service (-3.6 percent for revenue and -3.6 percent for volume) and Priority Mail (-2.4 percent for revenue and -2.7 percent for volume). These results are very similar to those from the FY2014 data.

Overall, the impact of adoption of Proposal One would be to enhance the reliability of the RPW system and reports. Increased confidence in the accuracy of forever stamp usage data allows those data to be treated as “near-census” and to be directly applied in the RPW process. These improvements avoid complications that might impede consistent reporting for certain RPW categories. The very high proportion of stamps now issued as forever stamps underscores the need for these changes.